surge petroleum inc.

2002 annual report

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Corporate Profile

Surge Petroleum Inc. is an emerging junior oil and natural gas exploration and development company, headquartered in Calgary, Alberta. Surge is focused primarily in Saskatchewan where the Company produces oil, and in Alberta where the production is both oil and natural gas.

The Company trades on the TSX Venture Exchange where its common shares are listed under the symbol "SPY".

Annual Meeting

Surge's Annual General Meeting of shareholders will be held on Wednesday, May 28, 2003 at The Altius Centre, Conference Room, 2nd Floor, 500 - 4th Avenue S.W., Calgary, Alberta, at 2:30 pm (Calgary time).

Abbreviations:

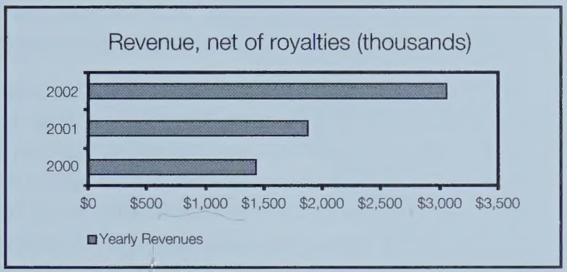
bcf	billion cubic feet
bbl	barrel
bbls	barrels
boe	barrel of oil equivalent (6 mcf = 1 boe)
boepd	barrels of oil equivalent per day
bopd	barrels of oil per day
CBM	coal bed methane
mcf	thousand cubic feet
mmcf/day	million cubic feet per day

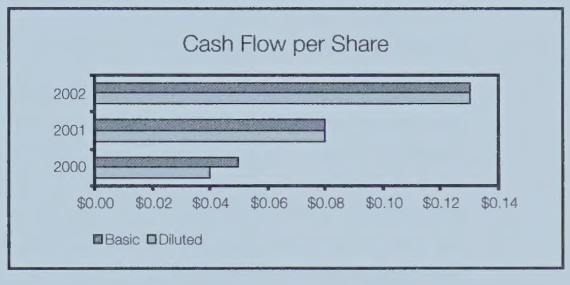
Corporate Highlights

Financial:

	2002	2001	% Change
Revenue, after royalties [1]	$ 3,055,935	$ 1,875,800	63%
Operational cash flow	$ 1,761,972	$ 900,608	96%
Working capital (deficiency) surplus	$ (479,510)	$ 29,261	
Long term debt	$ -	$ -	0%
Capital expenditures	$ 2,568,933	$ 1,957,651	31%
Common shares issued	13,562,949	13,454,949	1%
Profit before ceiling test write-down	$ 1,004,654	$ 206,900	386%
Ceiling test write-down, U.S. properties	$ 1,412,143	$ 5,679,343	-75%
General and administrative expenses (G&A)	$ 401,406	$ 165,216	143%
Line of credit:			
Operational, Unused	$ 1,300,000	$ 950,000	
Acquisitions, Unused	$ 1,000,000	$ -	
Cash flow per share, diluted	$ 0.13	$ 0.08	63%
Capital raised	$ 35,000	$ 534,916	

(1) Royalties averaged 15% of gross revenues in 2002 and 14% in 2001

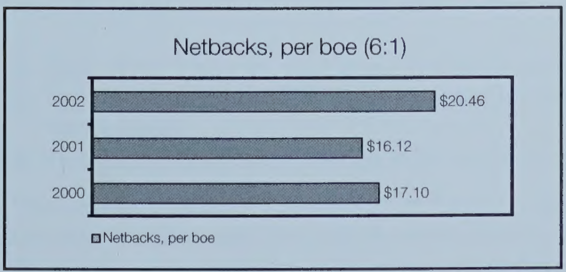


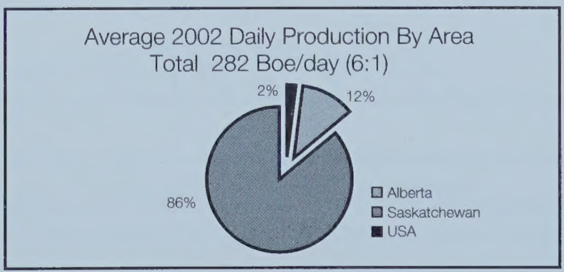


Operating:

	2002	2001	% Change
Reserves (proven plus probable)			
Oil (bbls)	791,000	708,000	12%
Natural gas (bcf)	2.099	3.044	-31%
Natural gas liquids (bbls)	-	1,800	-100%
Operating costs, per boe	$ 8.12	$ 11.80	-31%
Revenue received, per boe	$ 34.10	$ 32.79	4%
Finding costs:			
Proven, per boe	$ 18.53	$ 6.55	183%
Proven plus one half probable, per boe	$ 13.57	$ 3.52	286%
Average production rates - boepd (6:1)	282	166	70%
G & A, per boe	$ 3.90	$ 2.74	42%

All barrel of oil equivalent (boe) calculations are based on 6 mcf of gas per barrel of oil (6:1)





President's Report to the Shareholders

Surge Petroleum Inc. has completed its second full year of operations as at December 31, 2002. Year 2002 was a continuation of the plan that was initiated at the end of 2001 to focus its attention on Canadian exploration and development and divest of its U.S. assets. Surge has experienced significant growth this year, and the Company has now focused all of its money and efforts into exploring and developing its Canadian assets.

Review of 2002 and Outlook for 2003

Focused on developing its assets and cash flow, Surge will direct its efforts and funds into its Canadian operations and to continue to dispose of its United States operations. As at December 31, 2002 we were not successful in attracting a buyer for these U.S. assets. At the year-end the carrying value of these assets was $1,385,793 U.S., which was written down by $1,135,793 U.S. ($1,412,143 Cdn), leaving the net book value of these assets at $250,000 U.S., which in the opinion of management is the net realizable value. We are still working to dispose of these U.S. properties, and are currently spending very little time and few financial resources on these assets. At present we are negotiating with two prospective parties who may be buyers. We remain confident that Surge will be able to sell these assets in calendar 2003.

Plans for fiscal 2002 included the capital spending of $2,800,000; the Company spent $2,568,000. We are managing the cash resources of the Company using cash flow and bank lines of credit, and at the same time not exposing the Company to risky levels of debt. As at December 31, 2002, Surge did not have any bank debt and has been successfully developing its assets with cash flow. Due to the weak equity markets, and because the Company's shares are trading at less than fair market value, we intend to use the same method of financing for year 2003.

Additional plans for year 2003 include capital spending of $2,300,000 on land, seismic, and the drilling of up to eleven vertical wells and one horizontal well. Most of these projects fall within Surge's core area in southeast Saskatchewan. This core area developed last year includes the area of the Talisman Wide Area Farm-in. The drilling of all of these wells is dependent upon the results of various seismic and land programs, but several of these eleven prospective wells are aimed at identifying oil fields. In the event that any of these wells identify an oil field of some significance, then Surge will direct its monies with the objective of enhancing cash flow and increasing reserves. The identification of a field would include the drilling of additional horizontal wells to improve the drainage and cash flow when reserves have been identified. The Company will be the operator of all of these wells and will maintain a working interest of at least 50% in most cases.

Surge holds an interest in nine sections of land in Central Alberta. Geological and engineering studies by the Company indicate that these lands are natural gas bearing due to the existence of coal bed methane. During calendar 2002, Surge attempted to co-ordinate a joint venture project with its partners, but due to the weak prices of natural gas during most of the year, there was not a collective willingness to develop these properties.

With strong gas prices during the last quarter of 2002, and improving gas prices in calendar 2003, Surge is attempting to assemble contiguous lands to ours and develop a more extensive project. Surge is re-addressing several play areas in Alberta with the intent of developing opportunities for drilling gas wells this year.

The management and directors of Surge believe that the continuation of the plan initiated in 2002, and now focused into 2003, will achieve the same levels of success that Surge experienced in this past fiscal year. In addition to good prospects for internal growth, we continue to pursue the possibilities of merging this company with other oil and gas producers with the prospect of becoming larger, which should result in better share liquidity and enhanced share value.

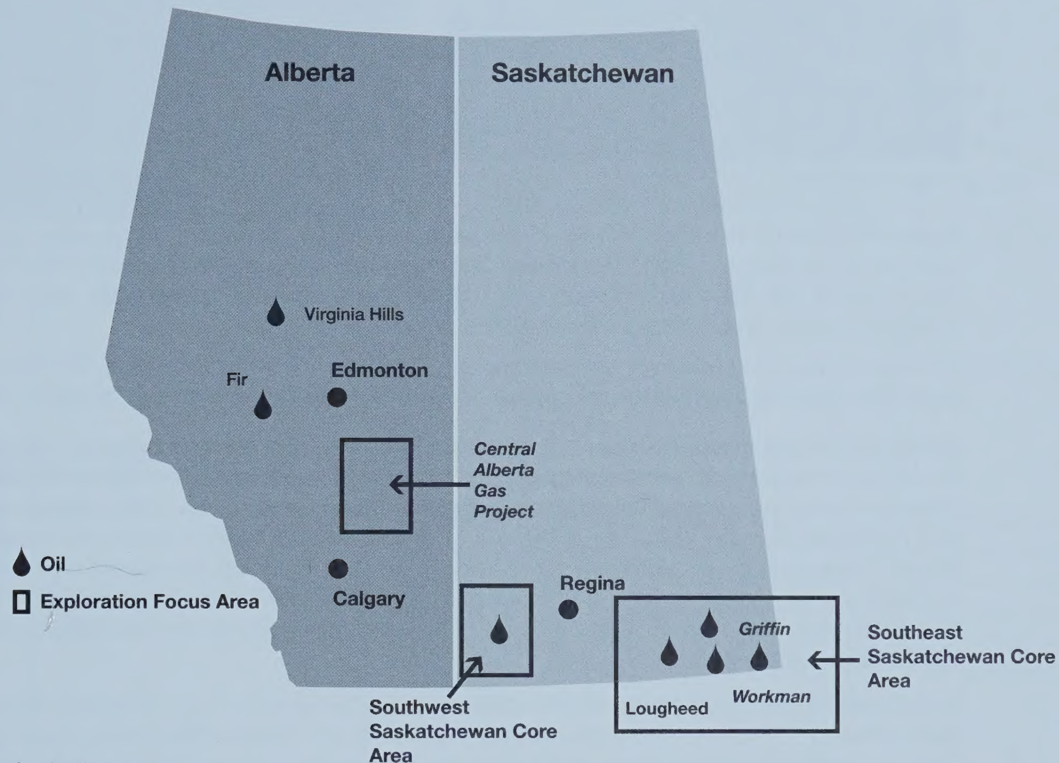
On Behalf of the Board of Directors

Frank P. Elliott
President and Chief Executive Officer

Review of Operations

The Company greatly expanded its activities in western Canada during fiscal 2002 focusing on oil potential in southeast Saskatchewan. A significant land base via crown sales and the Talisman Wide Area Farm-in resulted in a prospect inventory for 2003 and a number of successful wells in 2002. The following is a brief description of the project areas and the results of activities conducted during 2002.

Surge's Areas of Activity



Land Holdings

Surge's Canadian net undeveloped land base increased in its core areas from 1,425 acres at the beginning of 2002 to 4,541 acres by year-end. The growth occurred primarily in Surge's Saskatchewan Core Area where four new prospects at Hartaven, Innes, Griffin and Suffield were acquired or farmed in on. Surge's total gross undeveloped land base in Canada actually decreased in 2002 due to mineral expiries and divestments in Alberta non-core, non-producing areas.

Prospect Areas	Total Gross Acres(1)	Total Net Acres(2)	Undeveloped Gross Acres(3)	Undeveloped Net Acres(3)
Alberta	14,397	5,084	8,797	4,372
Saskatchewan	9,643	4,364	3,415	2,316
U.S.	36,832	18,416	34,912	17,456
Total All Areas	**60,872**	**27,864**	**47,124**	**24,144**

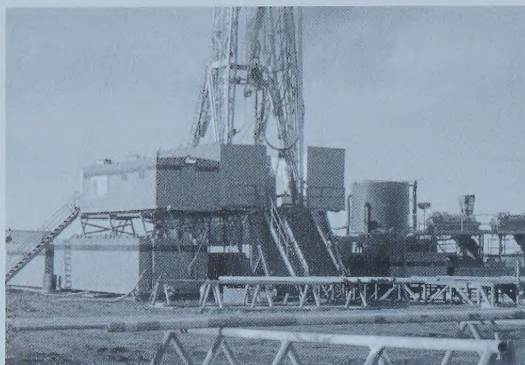
(1) "Gross Acres" means the acres of land in which Surge has a working interest.

(2) "Net Acres" means the sum of the products obtained by multiplying the number of gross acres by Surge's percentage working interest therein

(3) "Undeveloped land position" refers to those lands in which Surge has an interest and which have not been assigned reserves.

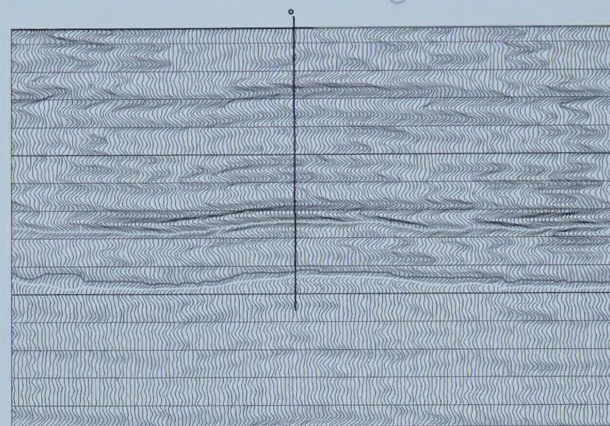
The Company plans to continue with its focus on light oil prospects in Saskatchewan and to begin to expand its inventory of natural gas prospects in central Alberta. In the United States the Company is attempting to divest of the majority of its assets through cash sales and farm-outs.

Drilling Activity



Drilling Rig at Griffin

Seismic Line with Drilling Location



Surge participated in the drilling of five (2.25 net) wells during 2002, resulting in four oil wells. Three horizontal oil wells were placed on stream at Griffin in southeast Saskatchewan and one vertical oil well in southwest Saskatchewan. One horizontal well drilled was sub-economic. Surge operated four of the five wells, which is consistent with our strategy to operate and control our expenditures.

Areas of Activity

During 2002, Surge focused the vast majority of its time and funds on the acquisition and development of Canadian oil and gas prospects. To obtain prospects and land, Surge's strategy was to farm-in on large land and seismic holdings of other companies in the oil prone southeast Saskatchewan area. This strategy would require detailed area geological mapping, utilization of the seismic data, and evaluation of the target company's land base and offsetting crown lands. In September, the Company announced a wide area farm-in deal with Talisman Energy in southeast Saskatchewan. This deal covered a seven township block, allowing Surge exclusive access to Talisman's lands and seismic. Given the size of the opportunity, Surge also brought in a 50 percent partner in exchange for reimbursement of overhead.

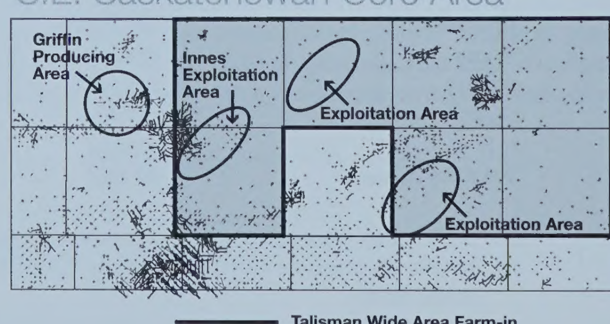
Surge holds interests in five prospects and three producing horizontal oil wells within this core block in southeastern Saskatchewan. This core block also defines the area of the Talisman Wide Area Farm-in. During 2002, the Company participated in the drilling of four (two net) wells resulting in three horizontal oil wells.

As a result of the Talisman Wide Area Farm-in and detailed regional geology combined with extensive seismic, the Company has identified and plans to acquire at least eight additional intermediate depth, medium and light oil prospects in this area during 2003. Most of the initial 2003 drilling program will consist of vertical wells, which with success, will lead to horizontal well follow-ups.

Surge's Southeast Saskatchewan Strategy

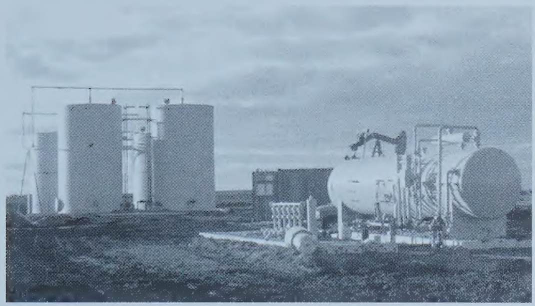
- Target focus area with medium depth (1,350 m) Mississippian oil potential
- Incorporate seismic into detailed regional geology
- Operate and control project timing, location and capital expenditures
- Working interests up to 50% of any one project
- Control processing and marketing of crude oil

S.E. Saskatchewan Core Area



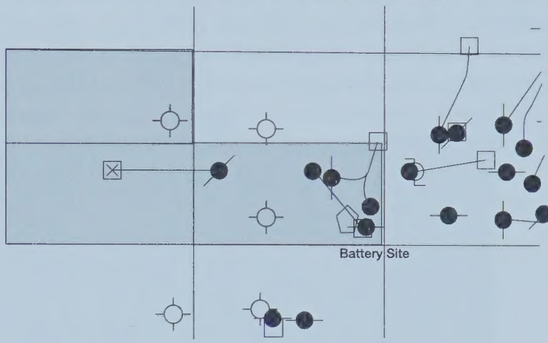
Griffin

Surge holds interests in 1,138 gross (618 net) acres and operates three horizontal oil wells producing from the Frobisher Formation. The initial well went on production in January 2002 and follow-up drilling occurred in May and October. Total production is currently 220 bbl/d (110 net). A battery and disposal well was recently built and completed which will reduce operating costs and allow for increased rates of production from the wells.



Surge operated Griffin Battery Under Construction

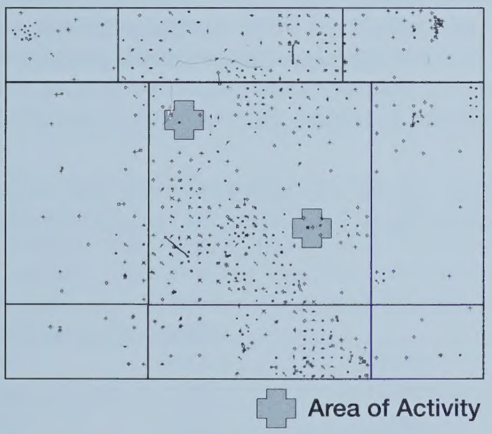
Griffin Production Area



Innes

Surge operates 663 gross (331 net) acres in this area. It is expected that the several wells will be drilled in this project area in 2003 targeting the Frobisher formation including an earning well for the Talisman Wide Area Farm-in.

Southwest Saskatchewan



At Suffield, in southwest Saskatchewan, Surge has a 25 percent interest in 640 gross (112 net) acres. A 3-D seismic survey was acquired in late 2002 and an exploration well (0.25 net) was drilled and cased as a potential oil well in December. The well was completed in early 2003 and additional drilling will follow if satisfactory production rates are confirmed. An additional exploration well will be drilled in 2003 in this area.

Central Alberta

Surge holds interests in 9,945 gross (4,175 net) acres of land covering shallow and intermediate depth natural gas properties. During the year, the Company acquired 2,640 gross (2,320 net) acres of land. The Company plans to drill gas prospects and acquire additional lands during 2003.

During 2002, the Company divested of its southern Alberta producing properties at Keho (shut-in) and Little Bow, which also reduced potential abandonment liabilities.

The Arkoma Basin Project

Surge initiated shutdown of operations in the United States during the past year. The reasons for the change in focus were marginal exploration and development drilling success, combined with the high cost of maintaining an operating organization in the U.S. The Company is currently divesting its interests in the U.S. to optimize benefits for our shareholders.

Production and Reserves

Flowlining Surge horizontal oil well

Drilling activities completed during the year resulted in the Company's production increasing by 70 percent from 166 boe/d in 2001 to an average of 282 boe/d in 2002. For the year, Surge produced 98,134 barrels of oil and 28.3 million cubic feet of natural gas. Over 90 percent of Surge's current production is coming from Saskatchewan. Surge operates approximately 44 percent of its production.

Reserves

During 2002, the Company concentrated its capital spending in Canada. Successful drilling in southeastern Saskatchewan contributed to an increase in total proven plus probable oil reserves from 708 mbbl compared to 791 mbbl in 2002. Production and divestments totaled 112 mbl, which was offset by discoveries and revisions to previous estimates of 195 mbbl. Surge's total proven and probable natural gas reserves decreased primarily as the result of divestments from 3.0 bcf to 2.1 bcf during the year. The Company's total established reserves (Proven plus 50% Probable) at year-end on a barrel of oil equivalent basis were 934 mboe. Approximately 73 percent of Surge's established reserves are oil.

Chapman Petroleum Engineering Ltd. evaluated the Surge's proved and probable oil and gas reserves as at January 1, 2003. The following table presents the consolidated results of these evaluations based on the escalated price case:

GROSS COMPANY INTEREST	Oil & NGL	Natural Gas	Total mBoe	Present Value at 10% DCF
As at January 1, 2003	(mbbl)	(mmcf)	(mboe)	(m$)
Proven Producing	507	59	517	5,474
Proven Non-Producing	60	911	212	1,467
Total Proven	**567**	**970**	**729**	**6,942**
Probable	222	1,130	410	2,774
Total Proven + Probable	**789**	**2,099**	**1,139**	**9,716**
50% Reduction for Risk	111	565	205	1,387
Established Reserves	**678**	**1,533**	**934**	**8,329**

"Gross" reserves are defined as the total of the Company's working interest share before deduction of any royalties owned by others.
"boe" reserves were determined by utilizing a six to one factor for the conversion on natural gas reserves to boe reserves.

Management's Discussion and Analysis

The following discussion and analysis is a review of Surge's financial and operating results and should be read in conjunction with the audited consolidated financial statements and accompanying notes.

Description of Business

Surge Petroleum Inc. is a resource company primarily engaged in the acquisition, exploration, development and production of natural gas and crude oil properties in Canada. Canadian activities are located in Alberta and Saskatchewan. The Company also has properties in the United States in the Arkoma Basin area of eastern Oklahoma and Arkansas, most of which are being divested and sold. Surge has changed its focus over the past year, moving from exploring in the U.S. to more emphasis in Canada, primarily in southeastern Saskatchewan. Surge Petroleum Inc. was formed in July 2000 by the merger of three predecessor companies, Plexus Energy Ltd., Peregrine Oil and Gas Ltd., and Aegis Energy Ltd. The final stage of this merger was completed in January 2001 when the U.S. subsidiaries of the three predecessor companies were merged with Surge's wholly owned U.S. subsidiary, Arkana Operating Co., Inc.

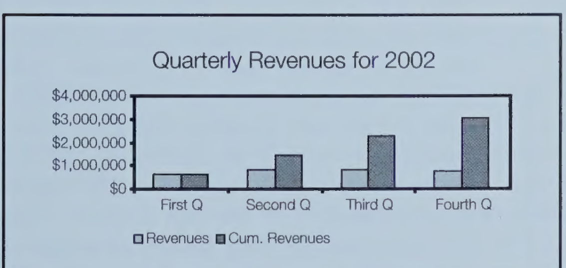
Operating Results

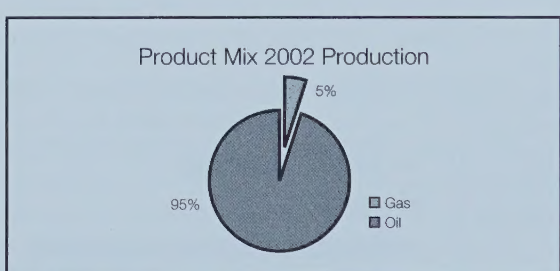
	For the Year Ended December 31, 2002			**For the Year Ended December 31, 2001**		
	Canada	United States	**Total**	Canada	United States	**Total**
Revenue	$3,011,888	$44,047	**$3,055,935**	$1,654,913	$220,887	**$1,875,800**
Net Operating Income (Loss)	759,829	(1,558,163)	**(798,334)**	788,722	(5,642,584)	**(4,853,862)**
Identifiable Assets	5,063,084	626,065	**5,689,149**	3,046,755	2,439,385	**5,486,140**
Capital Expenditures	2,224,094	87,040	**2,311,134**	880,512	1,077,139	**1,957,651**

* All results are stated in Canadian dollars

Production, Revenues and Royalties

Petroleum and natural gas revenues, net of royalties, for the year ended December 31, 2002 was $3,055,935, a 63 percent increase compared to $1,875,800 in 2001. For the three-month period ended December 31, 2002, revenue after royalties was $768,478 compared to $566,887 for the same period of 2001, an increase of 36 percent. The increase was due to new oil wells being brought onto production in Saskatchewan. Canada contributed 99 percent of gross revenues ($3,555,953) while the United States contributed one percent of gross revenues ($50,878).

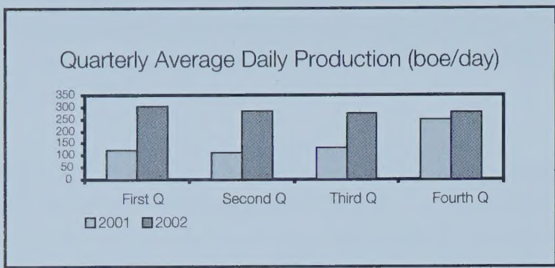


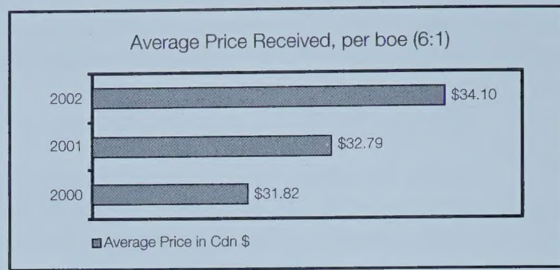


Total royalties averaged $5.52 per boe or 15 percent of gross income, up from $4.87 per boe or 14 percent of gross income in the prior year. Total royalty expenses were $550,897, an 88 percent increase from the $293,525 paid in 2001. The increase in royalties came as a result of increased total production and an increase in royalty rates associated with the Company's Saskatchewan oil production.

The Company's average gross price for crude oil for the 12 months ended December 31, 2002 was $34.67 per barrel, a decrease of one percent from the prior year. Average gross gas price for the 12 months was $3.72 per mcf, a 41 per cent decrease from the prior year. As a result of the substantial drop in gas price the Company's

average gross price per boe for the year ended December 31, 2002 was $34.10. The price of gas now seems to have recovered and both commodities are currently selling at very attractive prices.



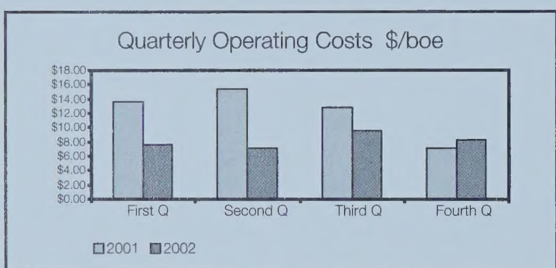


Reserves

Reserve information is discussed in the Review of Operations.

Production Expenses and Operating Netbacks

Operating costs for the year averaged $8.12 per boe, a significant decrease from the $11.80 per boe recorded in 2001. The primary reason for the reduction was the increase in oil production, where the average operating cost was $7.72 per bbl, down from $11.75 in the prior year. Canadian operating costs were $7.45 per bbl. The Company intends to maintain these lower operating costs by maintaining an ownership interest in the production facilities whenever possible and through the use of horizontal drilling technology in the development of the majority of its oil properties.

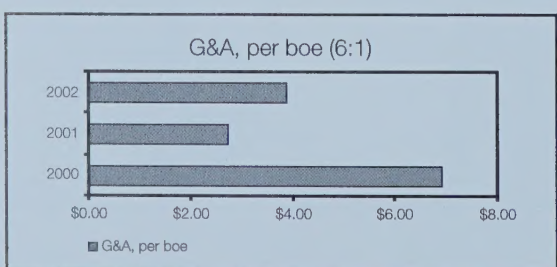


Total net production income increased to $2,185,867 during the period compared to $1,164,096 for the prior year. Net income before the ceiling test write-down and income taxes during the fourth quarter of 2002 was $771,082, an increase of 120 percent from the previous quarter.

Average netback per boe during the year was $20.46, a 27 percent increase from the $16.12 per boe recorded in 2001. Average netback per boe for the Canadian properties was $20.99 in 2002.

General and Administrative Expenses

General and Administrative (G&A) expenses increased to $401,406 in fiscal 2002 from $165,216 for the same period in 2001 but only increased 42 percent from $2.74 per boe in 2001 to $3.90 in 2002. G&A costs during the fourth quarter was only $1,068 compared to $67,181 for the same three months in 2001. This is a result of increased overhead recoveries from operating several wells. G&A costs are higher in 2002 as a result of discontinued operations in the U.S. resulting in less overhead recoveries, the high cost of running a public company, including the growth of Surge in Canada, however, it is expected that expenses on a unit basis (per boe) will continue to decline as production levels increase.



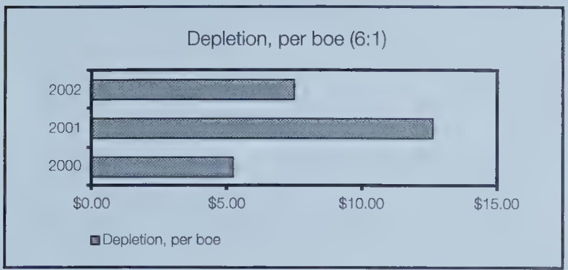
Interest Expenses

Interest expenses decreased from $30,101 in 2001 to $8,452 in 2002. This was a result of the increase in production and cash flow during the year and less reliance on long-term debt for the financing of new prospects.

Foreign Exchange

The Company receives the majority of its revenues in Canadian dollars, and the majority of the capital costs and operating expenses are paid in Canadian dollars. The company relies mainly on raising money from Canadian sources. A small portion of these Canadian funds are then converted into U.S. dollars and are deployed in the United States as needed. From time to time the exchange rates do fluctuate, but the company is capitalizing the majority of its American expenditures.

Depletion, Depreciatic



Total depletion and depreciation was $771,355 in 2002 compared to $761,879 in 2001. This increase occurred as a result of an increased capital base from capital expenditures. However, on a boe basis, depletion decreased from $12.63 per boe in 2001 to $7.50 in 2002. The provision for site restoration increased to $298,017 in 2002 from $285,575 in 2001 as a result of Surge's increased activity in well participation.

Ceiling Test Write-Dov

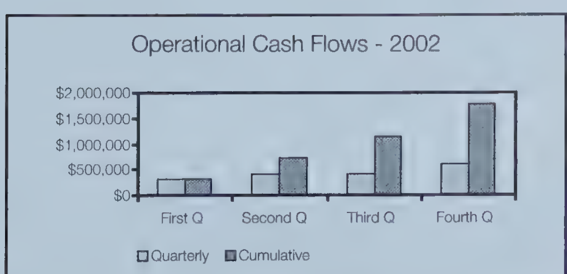
Based on the Reserve Reports prepared by independent petroleum engineers and management's decision to abandon exploration and development of its non-producing properties in the United States, it was determined that a ceiling test write down was required to reduce the carrying values of the U.S. resource properties to an amount that may be recoverable by the selling of the Arkoma assets. The engineering report indicated reserves in the U.S. were valued at $1,221,000. The carrying value was $1,806,583 before the write-down. Despite the engineering evaluation, management decided to write down the U.S. assets to $394,440 ($250,000 US), requiring a write-down of $1,412,143, which in management's opinion, reflects the net realizable value of the U.S. properties. No value was assigned to Surge's undeveloped U.S. land base in the ceiling test calculation.

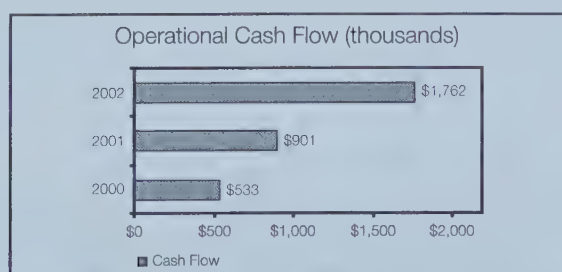
Income Tax

The Company has recognized a future income tax liability in the amount of $74,601 on its balance sheet reflecting the net tax effect of temporary differences between the carrying value of asset and liabilities for book purposes and the carrying value for tax purposes. The prior year reflected a future income tax asset in the amount of $542,236. A full description of this liability and its components are contained in Note 6 of the Notes to Financial Statements. There were current taxes paid during the year in the amount of $2,023 compared to $4,459 in 2001.

Net Income and

Net income before taxes and the ceiling test write-down for 2002 was $1,004,654, which compares to $206,900 in the prior year. Net income before taxes and the ceiling test write-down increased 57 percent from the prior quarter compared to an 86 percent decrease for the same three-month period in 2001. After the ceiling test write-down and income taxes, the Company recorded a net loss of $798,334. The Company had a net operating income of $759,829 in Canada while the United States operations showed an operating loss of $1,558,163. Operating income in Canada decreased four percent in 2002, mostly as a result of the future income tax liability.





Cash flow from operating activities for fiscal 2002 was $1,761,972 or $0.13 per share, compared to a cash flow of $900,608 or $0.08 per share for the prior period in 2001. Cash flow for the fourth quarter increased 52 percent form the third quarter compared to a 30 percent increase for the same three-month period in 2001. The increase during the year occurred mostly as a result of the 74 percent increase in production from the prior year.

For the year ended December 31, 2002, Surge's net capital expenditures amounted to $2,311,134, compared to $1,957,651 for the year ended December 31, 2001. The majority of capital spending (44 percent) was in the fourth quarter of 2002. Expenditures in Canada during the year increased from $880,512 in 2001 to $2,224,094 while spending in the U.S. declined from $1,077,139 to $87,040. The Company expects that the majority of capital spending during the 2003 period will be in Canada.

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The Company had a year-end working capital deficit of $479,510 compared to a surplus of $29,261 in 2001. This was a result of a very active drilling fourth quarter. Current assets at December 31, 2002 were $1,595,331, a 59 percent increase from the 2001 total of $1,002,243; current liabilities totaled $2,074,841, a 113 percent increase from 2001 when the total current liabilities were $972,982. Current liabilities include an advance of $629,322 received from partners in wells that the Company drilled during the quarter ending December 31, 2002. These remaining cash call amounts were not accounted for until the first quarter of 2003. The Company also has a $1,300,000 operational line of credit that it utilizes from time to time to cover short-term cash requirements. As of December 31, 2002, the line of credit was unutilized.

During the year the Company raised $35,000 (gross proceeds) from a private placement issue which, together with cash flow from operations, was used to fund drilling activities in Canada. The flow through issue of $498,353 raised in 2001 was fully expended in 2002. The number of shares outstanding at December 31, 2002 was 13,562,949. Surge's year-end closing share price was $0.45 and the trading range, was a low of $0.23 to a high of $0.45 per share.

In the normal course of business, the Company is exposed to market risks resulting from the fluctuations in foreign currency exchange rates and commodity prices. The Company mitigates these risks by seeking opportunities with significant hydrocarbon potential, by reducing the number of currencies, and by denominating revenues, expenses, and capital costs into one currency. To date the Company has not exposed itself to the derivatives market either in terms of commodity risk or currency risk.

At the present time a minority of the Company's revenues are derived from the United States. The Company is exposed to short-term currency fluctuations with respect to exchange rates. Historically, the revenues, expenses, and capital, which occur in the United States, are in U.S. dollars. Monies raised in Canada are converted to U.S. dollars, and this funding is used to satisfy the U.S. capital requirements. It is anticipated that within the year this process will reverse itself as the majority of spending and revenues will be located in Canada.

tal Risk

Surge endeavors to conduct its operations in a safe and environmentally responsible manner. The Company has prepared, and uses, safety, environmental risk management and emergency response manuals developed specifically for its operations. To date Surge has had no material environmental incidents or lost time due to accidents. As well, the Company reviews future site abandonment and site restoration costs annually.

Prices received for crude oil and natural gas are impacted, to a varying degree, by factors outside of the control of the Company. Crude oil prices are influenced by worldwide and quality differential prices adjustments, while both crude oil and natural gas are influenced by local market supply and demand fundamentals. At present, the company does not have any fixed rate contracts for either volumes or prices, but receives spot prices based on the daily production.

Net Asset Value

The following table calculates the net asset value of the Company at a discount rate of ten percent before tax as at December 31, 2002, with escalated and unescalated pricing.

(Thousands except per share amounts)	10%	
NAV @ 10% before tax	Escalated [1]	Unescalated [5]
Reserves (Chapman Petroleum Jan 1/03):		
- proven producing	$5,474	$7,786
- proven non-producing (developed)	595	777
- proven non-producing (undeveloped)	257	425
- probable @ 50%	1,010	1,412
Undeveloped land	502	502
Working capital	(480)	(480)
U.S. assets – disposition value	375	375
Other assets	85	85
Total Value	$7,818	$10,882
Number of shares	13,562,949	13,562,949
Net Asset Value per Share	$0.58	$0.80
Net Asset Value per Share, diluted	$0.56	$0.77

(1) The escalated prices used in the evaluation are as follows (Price Forecasts per Chapman Petroleum Engineering Ltd. report dated January 1, 2003):

DATE	WTI [2] $US/STB	Alberta Par Price [3] $CDN/STB	GRP [4] $/MMBTU	AECO Spot Gas (NIT) $/MMBTU
2003	25.00	38.06	5.00	5.40
2004	24.00	36.52	4.75	5.00
2005	23.00	34.98	4.50	4.70
2006	23.00	34.98	4.50	4.70
2007	23.35	35.51	4.50	4.70
2008	23.70	36.04	4.57	4.77
2009	24.05	36.58	4.64	4.84
2010	24.41	37.13	4.71	4.91
2011	24.78	37.69	4.78	4.99

(2) West Texas Intermediate (D2/S2) crude landed in Cushing, Oklahoma

(3) Equivalent price for Light Sweet Crude (D2/S2) landed in Edmonton, Alberta after exchange of .650 $US/$CDN and transportation charges of $0.50 CDN/STB

(4) Gas Reference Price (GRP) represents the average of all systems and direct (spot and firm) sales

(5) The unescalated price used for oil was WTI – US $31.23/STB (Edmonton Par – CDN $48.93/STB) and for gas was NYMEX – US $4.60/Mscf (CDN $5.58/Mscf)

The accompanying consolidated financial statements of Surge Petroleum Inc. and all information in this Annual Report are the responsibility of management. The financial statements have been prepared by management in accordance with generally accepted accounting principles and include certain estimates that reflect management's best judgments.

Management maintains a system of internal controls that provides reasonable assurance that all assets are safeguarded and to facilitate the preparation of relevant, reliable and timely financial information.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal control. The Audit Committee meets periodically with management and the auditors to satisfy approval of the financial statements to the Board.

The external auditors, Davis Daignault Schick and Co., Chartered Accountants, were appointed by the shareholders and have conducted an independent examination of the financial statements. The Audit Committee, has reviewed these statements with management and the auditors, and has reported to the Board. The Board of Directors has approved the financial statements, which are contained in the Annual Report.

Frank P. Elliott	Robert R. Hobbs
President & Chief Executive Officer	Chief Financial Officer

April 4, 2003

To the Shareholders of:

Surge Petroleum Inc.

We have audited the consolidated balance sheets of SURGE PETROLEUM INC. as at December 31, 2002 and 2001 and the consolidated statements of loss and deficit and cash flows for the years then ended. These consolidated financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the consolidated financial position of the company as at December 31, 2002 and 2001 and the consolidated results of its operations and cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Davis, Daignault, Schick & Co.

Chartered Accountants

Calgary, Alberta

March 6, 2003

Surge Petroleum Inc.
Consolidated Balance Sheets
As at December 31

	2002	2001
Assets		
Current		
Cash	$ 535,272	$ 43,486
Accounts receivable	1,060,059	958,757
	1,595,331	1,002,243
Investment in private company	83,875	83,875
Capital - Note 3	4,009,878	3,857,786
Future tax benefits – Note 6	—	542,236
	$5,689,084	$ 5,486,140
Liabilities		
Current		
Accounts payable and accrued liabilities	$2,074,841	$ 789,226
8% convertible debentures	—	183,756
	2,074,841	972,982
Provision for site restoration costs	298,017	285,575
Future income taxes - Note 6	74,601	—
Shareholders' Deficiency		
Capital stock - Note 5	8,644,027	8,831,651
Deficit	(5,402,402)	(4,604,068)
	3,241,625	4,227,583
	$5,689,084	$ 5,486,140

Director

Director

Consolidated Statement of Loss and Deficit
Years Ended December 31

	2002	2001
Revenue		
Oil and gas revenue net of royalties	$ 3,055,935	$ 1,875,800
Expenses		
Depletion and amortization	771,355	761,879
General and administrative	401,406	165,216
Interest on long-term debt	8,452	30,101
Well operating	870,068	711,704
	2,051,281	1,668,900
Income before ceiling test write-down	1,004,654	206,900
Ceiling test write-down – Notes 1 and 3	1,412,143	5,679,343
Loss before income taxes	(407,489)	(5,472,443)
Income taxes (recovery)		
Current	2,023	4,459
Future – Note 6	388,822	(623,040)
	390,845	(618,581)
Net loss for the year	(798,334)	(4,853,862)
Deficit, beginning of year	(4,604,068)	249,794
Deficit, end of year	$ (5,402,402)	$ (4,604,068)
(Loss) income per share:		
Basic	$ (0.06)	$ (0.41)
Diluted	$ (0.06)	$ (0.41)
Weighted average number of shares outstanding:		
Basic	13,529,504	11,799,363
Diluted	13,895,331	11,799,363

Surge Petroleum Inc.
Consolidated Statement o
For the Years Ended Decem

	2002	2001
Operating activities:		
Net loss for the year	$ (798,334)	$ (4,853,862)
Adjustments to reconcile income from operations to net cash provided:		
Ceiling test write-down	1,412,143	5,679,343
Depletion and amortization	746,899	508,042
Provision for site restoration	24,456	253,837
Current restoration charges	(12,014)	(63,712)
Future income taxes	388,822	(623,040)
	1,761,972	900,608
Changes in operating assets and liabilities:	1,175,557	(118,073)
Cash flows from operating activities	2,937,529	782,535
Investing activities:		
Proceeds of disposal of capital assets	257,799	—
Capital assets acquired	(2,568,933)	(1,957,651)
Cash flows used in investing activities	(2,311,134)	(1,957,651)
Financing activities:		
8% convertible debentures	(175,000)	(25,000)
Proceeds of share issue, net of issue costs	40,391	616,893
Cash flows (used in) from financing activities	(134,609)	591,893
Net increase (decrease) in cash	491,786	(583,223)
Cash, beginning of year	43,486	626,709
Cash, end of year	$ 535,272	$ 43,486
Cash flow per share:		
Basic	$ 0.13	$ 0.08
Diluted	$ 0.13	$ 0.08
Supplementary information:		
Interest paid	$ 8,452	$ 36,644
Taxes paid	$ 2,023	$ 4,459

Financial Statements
and December 31, 2001

The company's activities prior to December 31, 2001 have been primarily directed towards the acquisition, exploration and development of natural gas properties in Oklahoma and Arkansas.

As at December 31, 2001, the company made a strategic decision to change its primary oil and gas exploration focus and direct its efforts and finances towards its Canadian properties and to reduce its focus on its United States properties.

The company has decided that its objective will be to divest of its interests in the United States and has decided to state the value of these properties and lands at net realizable value. The result of this decision is that the company has recorded a ceiling test write-down of $1,412,143 (2001 - $5,679,343), which has been recorded in the financial statements (see Note 3).

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles and reflect the following policies:

a) Basis of consolidation

These consolidated financial statements include the accounts of the company and its wholly owned U.S. subsidiary, Arkana Operating Co., Inc.

b) Petroleum and natural gas properties

The company follows the full cost method of accounting for oil and gas operations, whereby all costs associated with the exploration for, and development of, oil and natural gas reserves are capitalized by cost centre. The company operates in two cost centres, Canada and the United States of America. Such costs include property acquisition expenditures, geological and geophysical expenses, carrying charges of non-productive properties, costs of drilling productive and non-productive wells, and plant and production equipment costs. Financing and administrative costs are capitalized only to the extent that they are directly related to capital projects. Proceeds from the sale of any interests in oil and gas properties are applied against capitalized costs, with no gain or loss recognized, unless such a disposition would alter the rate of depletion by at least 20%.

Costs of acquiring and evaluating unproved properties are initially excluded from the costs subject to depletion and amortization. These properties are assessed regularly to ascertain whether impairment has occurred. When production commences or the property is considered to be impaired, the cost of the property or the amount of the impairment is added to the costs subject to depletion and amortization.

Costs accumulated by the cost centre are depleted using the unit of production method based on estimated net proven reserves, as determined by the company and reviewed yearly by independent consulting engineers. Natural gas production and reserves are converted to equivalent units of measure using a relative energy content.

The company applies a ceiling test to the costs of developed properties to ensure that capitalized costs (net of accumulated depletion) do not exceed the estimated future net revenues from production of proven reserves less estimated future administrative, financing and income tax costs. Future net revenues are based on prices and costs prevailing at the year end.

c) Other capital assets

Amortization of other equipment is provided using the declining balance method at rates ranging from 20% to 30% per annum.

d) Future site restoration costs

Estimated future site restoration and reclamation costs are amortized using the unit of production method. These costs are based on management's estimates of the anticipated costs of site restoration net of expected recoveries. The estimates are based on current costs, existing legislation and industry standards. Actual removal and site restoration costs are charged against the accumulated provision as incurred. In the current year $12,014 (2001 – $63,712) of actual costs were charged against the provision.

e) Measurement uncertainty

The amounts recorded for depletion and amortization of capital assets and the provision for future site restoration costs, are based on estimates of reserves and future costs. By their nature, these estimates and those related to future cash flows used to assess impairment, are subject to measurement uncertainty and the impact on future financial statements resulting from changes in such estimates could be material.

f) Joint ventures

Substantially all of the company's oil and gas related activities are conducted jointly with others and, accordingly, these consolidated financial statements reflect only the company's proportionate interest in such activities.

g) Flow-through shares

The company finances a portion of its exploration and development activities through the issue of flow-through shares. Under the terms of the flow-through share issues, the tax attributes of the related expenditures are renounced to subscribers. To recognize the foregone tax benefits to the company, share capital is reduced and future income taxes are increased by the estimated amount of future income taxes payable when the renounced expenditures are incurred.

h) Investments

Long-term investments are carried at cost less permanent declines in value.

i) Earnings and cash flow per share

Effective January 1, 2001, the company adopted the new Canadian Institute of Chartered Accountants' recommendations for determining per share amounts. The new standard utilizes the treasury stock method in the determination of diluted per share amounts. Under this method, the diluted weighted average number of shares is calculated assuming the proceeds that arise from the exercise of outstanding "in the money" options and warrants are used to purchase shares of the company at their average market price for the period.

Prior to the adoption of the new recommendation, diluted per share amounts were determined using the imputed earnings method. The effect of this change did not result in a material change in the per share amounts reported.

j) Foreign currency translation

Financial statements of the company's foreign subsidiary are translated using the temporal method whereby all monetary assets and liabilities are translated at the rate of exchange at the balance sheet date. Non-monetary assets and liabilities are translated at exchange rates prevailing at the transaction date. Income and expenses are translated at rates which approximate those in effect on transaction dates. Gains and losses arising from restatement of foreign currency monetary assets and liabilities for each period end are included in earnings.

k) ## Stock-based compensation plans

The company grants options in accordance with the policies of the TSX Venture Exchange. No compensation expense is recognized when stock options are granted. Consideration paid for the shares on exercise of the stock options is credited to capital stock.

l) ## Financial instruments

The company's financial instruments are comprised of accounts receivable, accounts payable and accrued liabilities and convertible debentures.

i) ### Fair value of financial assets and liabilities

The fair values of financial instruments approximate their carrying amount due to the short term maturity or capacity for prompt liquidation.

ii) ### Credit risk

Virtually all of the company's accounts receivable are with customers in the oil and gas industry and are subject to normal industry credit risks.

iii) ### Foreign currency risk

The company is exposed to foreign currency fluctuations as oil and gas prices received are based on U.S. dollar denominated prices.

i) ### 2002

	Cost	Accumulated Amortization	Net Book Value
Oil and gas properties	$ 14,130,669	$ 10,179,859	$ 3,950,810
Other equipment	195,992	136,924	59,068
	$ 14,326,661	$ 10,316,783	$ 4,009,878

ii) ### 2001

	Cost	Accumulated Amortization	Net Book Value
Oil and gas properties	$ 11,837,880	$ 8,036,223	$ 3,801,657
Other equipment	177,644	121,515	56,129
	$ 12,015,524	$ 8,157,738	$ 3,857,786

As at December 31, 2002, the company decided to discontinue its exploration and development activities in the United States. As a result of this decision, the company has recorded a ceiling test write down of $1,135,793 U.S. or $1,412,143 Cdn. (2001 - $5,679,343). The U.S. assets will be carried on the records of the company at a value of $250,000 U.S., which in the opinion of management, is the net realizable value.

The cost of undeveloped property excluded from the depletion base as at December 31, 2002 was $80,854 (2001 - $1,072,905).

Note 4: Long-term debt

The company has an undrawn bank credit facilities available to a maximum of $2,300,000 at December 31, 2002. This loan has no fixed terms of repayment and is subject to a periodic review by the lender. Amounts outstanding bear interest at bank prime plus 1.0% to prime plus 1.5% and are secured by a $5,000,000 floating debenture and general security agreement over the company's assets.

Note 5: Share capital

a) Authorized

An unlimited number of Class "A" common shares

An unlimited number of Class "B" preferred shares

b) Issued

	Number of Common Shares		$
Balance, December 31, 2000	11,830,274	$	8,295,562
Shares cancelled	(94,644)		—
Issued pursuant to management compensation plan – Note 5 e)			
— prior years' shares vesting in current year	—		43,370
— vested	40,909		18,000
— non-vested	40,910		—
Private placement issue	350,000		122,500
Flow-through share issue	1,287,500		515,000
Estimated tax benefits renounced on flow-through shares - 2000	—		(80,804)
Share issue cost	—		(81,977)
Balance, December 31, 2001	13,454,949		8,831,651
Issued pursuant to management compensation plan – Note 5 e)			
— prior years' shares vesting in current year	—		18,000
Private placement issue	100,000		35,000
Exercise of options	8,000		2,000
Estimated tax benefits renounced on flow-through shares - 2001	—		(234,531)
Share issue cost	—		(8,093)
Balance, December 31, 2002	13,562,949	$	8,644,027

c)

Share purchase warrants outstanding

Balance December 31, 2001	Exercise Price	Expiry Date	Expired	Issued	Balance December 31, 2002
100,000	$0.65	April 2003	—	—	100,000
289,625	$0.40	Dec 2002	289,625	—	—
389,625			289,625	—	100,000

d)

Stock based compensation plans

The company has a stock option plan that permits the Board of Directors to grant stock options to employees, directors and officers and persons or companies who provide services to the company. Under the plan, the company is authorized to issue options to purchase, in aggregate, up to 10% of the issued and outstanding common shares. The options vest upon granting and expire not more than five years from the date on which the options were granted. Details of the company's options outstanding are as follows:

Balance December 31, 2001	Expiry Date	Exercise Price	Expired	Exercised	Repriced	Granted	Balance December 31, 2002
69,191	Jun 18/02	$0.50	69,191	—	—	—	—
9,091	Jun 23/04	$0.56	9,091	—	—	—	—
4,545	Jun 23/04	$0.66	—	—	—	—	4,545
80,000	Jul 13/05	$0.70	—	—	(80,000)	—	—
890,814	Jul 13/05	$0.90	531,838	—	(98,000)	—	260,976
—	Jul 13/05	$0.25	—	8,000	178,000	—	170,000
—	Jul 18/07	$0.25	—	—	—	428,006	428,006
—	Sep 19/07	$0.32	—	—	—	185,000	185,000
1,053,641			610,120	8,000	—	613,006	1,048,527

The company accounts for its stock-based compensation plans using the intrinsic-value method whereby no costs have been recognized in the consolidated financial statements for stock options granted to employees and directors. Effective January 1, 2002, as required under Canadian generally accepted accounting principles, the impact of using the fair value method on compensation costs and recorded net income must be disclosed. If the fair value method were used for stock options granted subsequent to January 1, 2002, the company's net loss and net loss per share for the year ended December 31, 2002 would have been the pro forma amounts indicated below:

Net earnings:	
As reported	$ (798,334)
Pro forma	$ (916,778)
Net earnings per common share - basic:	
As reported	$ (0.06)
Pro forma	$ (0.07)
Net earnings per common share - diluted:	
As reported	$ (0.06)
Pro forma	$ (0.07)

Under the provision of Handbook section 3870, the pro forma disclosures above include only the effects of stock options granted or modified by the company subsequent to January 1, 2002.

The fair value of each option granted was estimated on the date of grant using the Modified Black-Scholes option-pricing model with the following assumptions:

Risk-free interest rate	4.5%
Estimated hold period prior to exercise	3 to 5 years
Volatility in the price of the company's common shares	65%

e) Management service contracts

During 2001 the company entered into contracts with certain senior management whereby it issued 81,819 common shares. These shares vest with the management upon completion of the service contracts. The company has recorded share capital and general and administrative expenses of $18,000 (2001 - $61,370) related to these contracts. At December 31, 2002, no (2001 – 40,910) shares remain unvested.

f) Flow-through shares

On December 31, 2001, the company completed the private placement of 1,287,500 flow-through Class "A" common shares at $0.40 per share. Under the terms of the flow-through share agreement, the company committed to and incurred $515,000 of resource expenditure by December 31, 2002.

Income taxes differ from the results which would be obtained by applying the combined federal and provincial income tax rates to earnings before income taxes.

The difference results from the following:

	2002	2001
Effective tax rate	45.54%	45.18%
Expected income tax expense (recovery)	$ (185,570)	$ (2,472,450)
Non-deductible Crown payments, net of ARTC	43,198	49,592
Resource allowance	(200,363)	(35,792)
Recognition of tax benefits not previously recorded	—	(729,008)
Tax benefit of ceiling test write-down of U.S. properties and U.S. operating losses not recorded	742,364	2,565,927
Other	(8,784)	3,150
	$ 390,845	$ (618,581)

At December 31, 2002, the company had estimated non-capital losses of $70,227 (2001 - $665,201) which may be available to offset future Canadian taxes and net operating losses of $5,870,921 (2001 - $5,126,467) which may be available to offset future income taxes in the United States.

In addition, the company has tax pools related to exploration and development and unamortized capital costs of $3,001,182 (2001 - $2,188,692) which may be available for deduction against future Canadian taxable income and $5,870,921 (2001 - $5,712,947) which may be available for deduction against future taxable income in the United States.

Future income taxes reflect the net tax effects of temporary differences between the carrying value of assets and liabilities for book purposes and the carrying values for tax purposes. The components of the future income tax asset (liability) are as follows:

	2002	2001
Tax pools in excess of net book value of capital assets	$ 2,214,256	$ 1,827,013
Non-capital losses	2,297,510	2,616,675
Provision for site restoration	135,717	180,292
Share issuance expenses	38,715	45,707
	4,686,198	4,669,687
Valuation allowance on U.S. tax pools and net operating losses	(4,760,799)	(4,127,451)
Future tax (liability) asset	$ (74,601)	$ 542,236

Note 7: Segmented information

The company is involved in the exploration and development of petroleum and natural gas properties in Canada and the United States of America. Operations and identifiable assets by geographic region are as follows:

	2002	2001
Revenue		
Canada	$ 3,011,888	$ 1,654,913
United States	44,047	220,887
Operating income (loss)		
Canada	759,829	788,722
United States	(1,558,163)	(5,642,584)
Identifiable assets		
Canada	5,063,019	3,046,755
United States	626,065	2,439,385
Capital expenditures - net of recoveries		
Canada	2,224,094	880,512
United States	87,040	1,077,139

Note 8: Related party transactions

a) Consulting fees of $277,330 (2001 - $195,395) were paid to companies controlled by directors and officers of Surge Petroleum Inc.

b) During 2002, the company acquired Canadian royalty interests from companies controlled by the President, Chief Financial Officer and Chief Operating Officer for $61,500 which, in the opinion of management, represented fair market value.

c) 8% convertible debentures and accrued interest in the amount of $185,372 (2001 - $183,756) were held by companies controlled by the President and Chief Financial Officer of Surge Petroleum Inc. The debentures and accrual interest were repaid during 2002.

d) During 2001, the company entered into an agreement with companies controlled by the President and Chief Financial Officer to participate in the drilling of a well in the United States. The well was unsuccessful and abandoned. As a result of these agreements, accounts receivable includes $nil (2001 - $93,857) due from the company controlled by the President and $nil (2001 - $55,285) due from the company controlled by the Chief Financial Officer.

Note 9: Commitments

The company is committed under a lease agreement for the rental of premises to the following annual payments, exclusive of realty taxes and other charges:

2003	$ 46,092
2004	46,092
2005	30,728

Corporate Information

Officers and Directors

Frank P. Elliott, P. Geol.
Director, President & Chief Executive Officer

Robert R. Hobbs, C.M.A.
Director, Chief Financial Officer, Corporate Secretary

Peter D. Sametz, P. Eng.
Director, Chief Operating Officer

Gregory C. Collver, Barrister & Solicitor
Director

Jeffrey J. Scott, M.B.A.
Director

Dawn Bishop, B. Comm.
Assistant Corporate Secretary

Head Office

Suite 1200, 736 – 6th Avenue SW
Calgary, Alberta T2P 3T7
Telephone: (403) 262-4937
Facsimile: (403) 264-5505
E-mail: info@surgepetroleum.com
Website: www.surgepetroleum.com

Bankers

National Bank of Canada
Calgary, Alberta, Canada

Evaluation Engineers

Chapman Petroleum Engineering Ltd.
Calgary, Alberta, Canada

Auditors

Davis Daignault Schick & Co.
Calgary, Alberta, Canada

Transfer Agent

Computershare Trust Company of Canada
Shares Listed on TSX Venture Exchange – "SPY"

Legal

Gregory C. Collver
Paul D. Trotter

The Annual Information Form may be obtained on request by calling the Company.

surge petroleum inc. 2002 annual report

Surge
Petroleum Inc.

Suite 1200, 736 - 6th Avenue S.W.
Calgary, Alberta T2P 3T7
Telephone: (403) 262-4937
Fax: (403) 264-5505
info@surgepetroleum.com
www.surgepetroleum.com